U.S. Capital Advisors

USCA Friday Midstream Recap

May 7, 2021

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Earnings – ET, LNG, TRGP

- **ET:** *Uh...well...Positive...I guess.* Would call this the beat to beat all beats in the history of Midstream. Almost all in the Intrastate segment as ET noted a $1.5B benefit from higher storage margins and a $1.1B benefit from higher gas sales and retained fuel revenues. Some offsets, but a net ~$2.4B positive impact for the year. EBITDA guidance increased by the amount of the storm benefit plus another $100mm to a new midpoint of $13.1B (not including impact of ENBL merger). ***And we think that could move higher given they have not booked all the storm gains due to some disputes with counterparties.*** We estimate the one-time windfall worth 80c/unit to ET, after factoring in units issued for ENBL transaction.
- **ET (cont'd):** ET reduced debt by $3.7B during Q1. We estimate that the storm windfall lowered by just over 0.2x, and that the full $3.7B debt pay down reduced leverage by 0.34x. We're guessing it is enough to take them off negative credit outlooks. Growth capex +$150mm, to $1.6B on combo of new Permian Bridge project (rich gas line), several smaller project additions and some acceleration of '22 spend into '21. ***Finally, just a darn good conference call, emphasizing the things they did during Uri to keep gas flowing (as opposed to the windfall), talking head-on about improving ESG metrics, and exuding lots of confidence about the outlook for their base business.***
- **LNG:** *Positive.* Monster 40% EBITDA beat vs. consensus, another guidance raise, and new accelerated schedule for SPL Train 6 (now H1'22 vs. prior H2'22). Unlike monster EBITDA beat in Q2'20, this was not driven by an acceleration of revenue recognition from cancelled cargoes, but rather a reflection of the volatile LNG and gas markets in Q1. For second quarter in a row, raised EBITDA guidance by $200mm to new range of $4.3-$4.6B. ***Biggest elements of most recent guidance revision include a roughly $1/mmbtu improvement on the 50 TBtus of open capacity as of last ccall (~$50mm) and 30+ TBtus of new production added to the 2021 forecast at a ~$3/mmbtu margin (~$100mm).***
- **TRGP:** *Positive.* Also a monster EBITDA beat and full year EBITDA guidance raise. Raise in line with Q1 beat plus impact of higher assumed commodity prices in guidance. Adj EBITDA $516mm, a 20%+ beat vs. USCA/street at $401mm/$418mm. Raised full year EBITDA guidance by $125mm, or 7%, to midpoint of $1.85B. ***Bulk of raise appears to be related to Q1 outperformance (~$100m in aggregate composed of a $30mm net Uri benefit combined with unquantified cost savings and non-storm related NGL marketing),*** as we estimate the higher commodity price assumptions are worth ~$25mm of the raise. Leverage now expected to be 4x at year-end vs. prior 4.25x.

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Earnings – DCP, MPLX, EPD, AWK, WMB

- **DCP:** *Positive.* DCP finally firmed up Uri impacts as a ~$60mm hit to Q1, bringing EBITDA down to $275mm, a 10% beat vs. USCA/Street. ***Implies ex-weather impact, EBITDA would have been ~$335mm, which would have been a record quarter and beaten pre-Uri street estimates of ~$300mm.*** Real driver of beat was G&A costs of $38mm, down ~$25mm from 2020 quarterly average. FCFaD of $89mm beat vs. USCA's $45mm on higher EBITDA and $19mm lower capex. No change to full year guidance.
- **MPLX:** *Positive.* Adjusted EBITDA +6%/5% vs. USCA/Street, driven by better-than-expected G&P results (higher NGL prices & lower opex). ***Repurchased $155mm of common units in Q1 (introduced $1B buyback program in Q3'20).*** Liquidity includes $24mm in cash and $2.7B available through their revolving credit facility.
- **EPD:** *Neutral.* Big beat, but largely offset in our view by bits and pieces in release about y/y declines in Eagle Ford and Permian. About $250mm storm benefit. No change to capex guidance, and LT capital run rate of $1.5-$2.0B/yr. Think spread/marketing margin >$500-$600mm for the year. ***Opened kimono a little more on energy transition.*** Doing deep dive review on carbon technologies, review of evolutionary technologies, including hydrogen, and looking at sequestering their own carbon and plastics recycling. ***Waiting for clarification on Biden tax policy before pulling trigger on buybacks.***
- ***AWK:*** *Neutral.* In line quarter and no change to recently issued guidance. ***Remain confident that sale of NY assets will close.*** Delay does not impact timing for equity issuance. Filed rate case in WV (5% of revenues) in April, requesting a $32mm revenue increase with a 10.5% ROE. 10-Q noted a subsidiary, American Water Resources, received a subpoena from the U.S. Attorney's Office for the Eastern District of NY seeking information about their operations and contractor network in the New York City area. Company does not believe the investigation will have a material adverse effect on them.
- **WMB:** *Neutral.* Beat EBITDA by $100mm or 7%, but all on winter storm benefits. Raised '21 guidance by $100mm, but one-time storm/other impacts were ~$126mm, so same amount as beat. Leverage 4.2x and expected to end year at that level, down from prior 4.25x. ***WMB is now below their 4.25x Debt/EBITDA target. Market looking for guide posts on capital allocation, but WMB still reviewing internally.*** FCF after dividends and capex $104mm vs. $(47)mm in Q1'20. ***Announced purchase of Sequent Energy, a gas marketing firm,*** from SO for $110mm, including $60mm of working capital. We find that a bit of a head scratcher – see below for more. Should hear something over the next 30-60 days on E&P partner to develop recently acquired Haynesville and Wamsutter properties.

Earnings – NS, ENB, TRP, ENLC, ALTM

- **NS:** *Neutral.* Quarterly EBITDA 3% light vs. consensus on the winter storm, but full year guidance unchanged. ***Raised expectations for Permian 2021 volume exit rate from ~475 mbpd to 500 mbpd*** and expect refined product system at ~100% of pre-pandemic levels for remainder of 2021. Reiterated expectation for 2021 EBITDA to be comparable to 2020 ($723mm) when adjusted for the sale of Texas City assets (USCAe ~$10mm of EBITDA). Will publish first sustainability report later this year.
- **ENB:** *Neutral.* EBITDA largely in line and no change to guidance. Continue to progress on small wind and solar projects, but nothing that moves the needle in a meaningful way. ***Ballpark, would say ~75% of questions on ccall focused on energy transition.*** Segments pretty much inline except: 1) Green Power, with a $34mm or 28% beat vs. USCA, but all on a one-time promote fee; and 2) Energy Services, with a $75mm loss vs. USCA at breakeven, on the lack of basis and quality diffs. ***ENB now expects Energy Services to record a loss in 2021.*** Expect mainline throughput to average 2.8 mmbb/d in 2021 (USCA at 2.8), but expect Q2 to average 2.6 mmbpd due to higher refinery and upgrader maintenance.
- **TRP:** *Neutral.* Adjusted EBITDA in line with consensus. Large KXL impairment taken in Q1, but expected. ***No update on expected costs or timing delays associated with Coastal GasLink project.*** US Gas Pipes was a C$63mm beat vs. USCA (6%) on Columbia Gas implementing new rates effective Feb 1 as a result of the rate case filed in 2020 (new rates remain subject to refund pending outcome of rate case). Power and Storage was a C$47mm beat (35%), though drivers unclear.
- **ENLC:** *Neutral.* EBITDA beat both USCA and street, but otherwise messy quarter with sizeable beats and misses at the segment level from disparate Uri impacts. Announced $60mm acquisition of Amarillo Rattler (~$11mm book value) for expected 6x 2022 EBITDA multiple. Net, net OK had largest negative impact from Uri which, combined with roll-off of $17mm MVC in Q1, led to segment profit declining 46% vs. Q1'20. ***Also laid out various GHG reduction targets – notably, targeting net zero emissions by 2050.*** Interim targets include 30% reduction in methane emissions by 2024 and 30% reduction in CO2e emissions by 2030 (both relative to 2020 baseline).
- **ALTM:** *Neutral.* Quarterly EBITDA essentially in line, with lower EBITDA from JVs offset by a $7.2mm power credit (assuming as a result of Uri) and higher G&P volumes and margins (~$3mm). Modest 2% increase in EBITDA guidance midpoint. ***Raised midpoint of EBITDA guidance $5mm from $250mm to $255mm on higher G&P volumes and Q1 performance.*** Raised G&P volume expectations to 370-410 mmcf/d from 360-400. New volume guidance incorporate two completed DUCs in Q1 and five DUCs expected to be completed in Q2.

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Earnings – SMLP, WTRG, ETRN, PAA

- **SMLP:** *Neutral.* Quarterly EBITDA and DCF beats offset by unchanged guidance and lower volumes across the board. Gas volumes -7% vs. Q4'20 and flat y/y. Bakken crude volumes -8% from Q4 and -34% from Q1'20. Reduced revolver debt by $55mm in Q1, and are ***working on a holistic solution to refinance 2022 senior notes (~$234mm) and revolver ($802mm drawn at March 31).*** Double E Pipeline: $4.6mm investment in pipeline during the first quarter and expect credit facility to fund the majority of remaining capital commitment. Expect completion to be at or below $425mm, gross and in-service by 4Q'21.
- **WTRG:** *Neutral.* EBITDA, at $312mm a 2% beat vs. USCA's $305mm. Net Income $184mm, a 7% beat vs. USCA's $171mm, with incremental beat on higher Other Income and lower effective tax rate. 2021 guidance unchanged. Expect to file rate case in PA in 2H'21. ***Continue to be adamant they will close DELCORA acquisition.***
- **ETRN:** *Slight negative.* Earnings beat, but largely on non-cash derivative gain and slight, 1% earnings guide up, but once again delayed MVP in service and raised cost estimate. ***Pushed MVP in-service date to summer 2022 and raised cost estimate to $6.2B (was $5.8-$6.0B)*** due to requested extensions of review time for permits from VA and WV. ETRN's portion is $3.1B, of which $2.3B has been spent to date. Positive news was that GPOR has agreed to honor their gathering contracts with ETRN.
- **PAA:** *Slight negative.* Earnings beat, but no change to full year EBITDA guidance and ***very weak Q2 and Q3 guidance relative to street likely to make investors nervous. Partially offset by further capex cuts (-$65mm) and thus higher expected free cash flow (+$100mm).*** No buybacks during Q1. Guidance for Q2'21 of ~$452mm vs. street $520mm/USCA $478mm. Guidance for Q3'21 of $516mm, vs. street $544mm/USCA $528mm. Have said up to 25% of FCF after dividends could be used for buybacks, but emphasized that could be lower as you have to take into account EBITDA lost from the asset sales.

Earnings Themes

- **Very Positive Sentiment:** What a difference a year makes – really two ends of the spectrum vs. May 2020. Management sounds so upbeat about prospects for their business and their balance sheets – you can hear it in their voices and that's despite the over-arching energy transition theme. It sets up well for 2022.
- **Winter Storm Uri Largely a Big Windfall:** Some massive, needle-moving beats, with only some slight negatives. Some longer-term implications as generators/utilities forced to contract for more firm storage/transportation.
- **So '21 Guidance Higher…:** Haven't tabulated the numbers yet, but definitely will see a nice tick up in '21 consensus driven not just by Uri, but more confidence in commodity prices and volumes.
- **…And Much More FCF:** This week was a blur, but gut feel is that almost every company we cover (ex Canadians) generated FCF after dividends and capex. Have been waiting on this for a long time and have to say it is so nice to see.
- **Plus Debt Reductions:** Also think we are going to see, in aggregate, a very nice step down in debt for the group, with companies achieving or having near-term visibility to long sought-after coveted debt targets.
- **Buybacks Taking a Backseat for Now:** Which means buybacks are on the back burner for now, with the exception of MPLX. We still think 2022 is the year of the buyback, assuming we don't see yet another black swan event.
- **Capex Guidance Largely in Check:** Market has been worried about capex creep, but we just didn't see it (so far). A little higher at ET, but with a >$2B storm benefit, you deserve to go out and buy a new pair of shoes.
- **Meaningful Cost Reductions:** Companies have been tackling costs for the last two years, but they are still coming down nicely. Unsure how much of this quarter's O&M declines were due to storm-induced lower volumes and how much was true cost reductions. And we are in the camp that inflation is about to take off. Love the cost cutting, but watching the outlook closely.
- **Energy Transition:** Dominated some of the calls (ENB) and missing from others (PAA), but each quarter you can see companies making a little more progress on getting their hands around potential opportunities. Way too early for meaningful investment, although we would not be surprised to see some smaller acquisitions over the next 12 months.

WMB Sequent Purchase

- **News:** WMB announced they are buying Sequent Energy from SO for $110mm, including $60mm of working capital. Closing is expected in Q3. Normally we wouldn't write about a $110mm acquisition for a $30B market cap company, but this is interesting.
- **Who is Sequent?:** Gas marketing company formed in 2001 within AGL Resources (former Georgia utility). Sequent, based in Houston, is the 6th largest gas marketer in North America (based on Q4'20 volumes). As part of their business they have contracts for ~1.1 Bcf/d of firm transportation capacity on interstate gas pipelines or up to 5.8 Bcf/d when you include where they are listed as an agent of the shipper. And they have ~15 Bcf of contracted gas storage, or up to 38 Bcf when you include where they are listed as an agent.

Top NA Gas Marketers (Q4'20)

Company	Bcf/d
BP	16.8
Macquarie Energy	11.8
Shell	10.6
Tenaska	10.0
Conoco Phillips	8.3
Sequent	6.9
Direct Energy	6.6
Mercuria Energy	4.8
J. Aron	4.7
Morgan Stanley	4.4

Sequent Contracted Volumes

Pipeline	Transportation Contracts (mmcf/d)			Storage Contracts (Bcf)		
	As Shipper	As Agent	Total	As Shipper	As Agent	Total
Texas Eastern		950	950			
Transcontinental	120	814	934		15.0	15.0
Rockies Express		900	900			
Tennessee Gas	145	610	755		3.1	3.1
ANR Pipeline		683	683	3.0		3.0
Natural Gas Pipeline Company	134	205	339	7.0	1.1	8.1
East Tennessee Natural Gas	75	128	203			
Northern Border	196		196			
Columbia Gas	22	153	175			
Enable Gas	150		150			
Gulf South		96	96	3.2	1.1	4.4
Southern Star				2.1		2.1
National Fuel Gas Supply					2.3	2.3
Other	221	166	387			
Total	**1,062**	**4,705**	**5,767**	**15.4**	**22.7**	**38.0**

Source: S&P Global, SNL, USCA

WMB Sequent Purchase, cont'd

- **WMB Ccall Comments:** WMB currently markets ~1 Bcf/d, so this will propel them to a top five-ish position. They expect Sequent to generate ~$20-$30mm of EBITDA/yr.
- **SO Call Comments:** On their earnings call last week, SO announced they were selling Sequent and provided some metrics. "We probably tie up something on average like $200mm worth of working capital so we have to provision for that within our credit facilities and then because of the gross revenue or gross sales associated with that business in forward positions probably something like another $800mm worth of parental support." "If you look at Sequent even prior to when Southern made the acquisition say from 2010 forward, they've averaged ~$40mm in net income. They had two years – one was $260mm and one was $163mmn where they really blew out earnings. Other than that the earnings were near zero." In Q1'21, Sequent generated ~$200mm of net income.
- **Our Thoughts:** ***Sounds like WMB is buying Sequent not because they see some step change in gas volatility or marketed volumes, but because they want maximize commercial opportunities by having a better understanding of daily gas market dynamics.*** Because Sequent has always been owned by a utility, in our view, it has been more de-risked than traditional gas marketing businesses. That said, marketing businesses have scorched more than just a handful of companies, and we are a bit jaded by covering WMB in early 2000s, when multiple downgrades in their debt created a marketing-driven liquidity crisis that almost sent them into bankruptcy. Yes, WMB is a very, very different company today, but that memory is still fresh, so we are in a show-me mode on this acquisition.

Midstream Link Library

Below are links to PDF versions of our recent Friday Notes, as well as other USCA Midstream publications.

Recent Friday Notes

- OKE, MMP, CEQP Earnings, Money Flows, Frac Efficiency and Oil Supply Growth, 914 Data, NGL Data Points 4.30.21
- KMI Earnings, Storage Stats, Proxy Tidbits 4.23.21
- Misc Tidbits, EIA DPR Data 4.16.21
- DAPL Decision, Refresh on Permian Gathering Data 4.9.21
- Clean Energy SPACtivity, Clean Energy Money Flows, Energy Money Flows, Panhandle Rate Case, 914 Data, NGL Data Points 4.1.21
- Misc. Tidbits, Midstream Headcount 3.12.21
- EPD Analyst Day, Money Flows, FCF to EV Analysis, 914 Data, NGL Data Points 3.5.21
- Earnings Recaps, Earnings Themes, Misc Tidbits, AWK Analyst Day, Fun with 13-Fs, Short Interest 2.26.21
- Earnings Recaps, ET Acquisition of ENBL, Texas Deep Freeze 2.19.21
- Earnings Recaps, Solving the Permian Pipe Problems, Coalition for RNG Fireside Chat, RDS Strategy Day 2.12.21

Other Publications

- USCA Q1'21 Midstream Earnings Preview 4.20.21
- Tracking Midstream Returns 3.31.21
- USCA Q4'20 Earnings Recap 3.10.21
- KMI Analyst Meeting Preview 1.22.21
- Initiating Coverage of WTRG 1.21.21
- Initiating Coverage of AWK 1.21.21
- USCA Q4'20 Earnings Preview 1.20.21
- USCA Q3'20 Earnings Recap 11.19.20
- USCA Q3'20 Earnings Preview 10.14.20
- Initiating Coverage of WES 8.31.20

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Price Target Methodology:

Utilities
We value utilities on a P/E basis.

C-Corps
For C-Corps, our price targets are based on a sum-of-the parts analysis. In our sum of the parts analysis, we value various business segments on a multiple of forward year(s) EBITDA, with multiples ranging from ~3x to ~12x. The spectrum reflects a wide range of contract lives, commodity sensitivity, volume risk, customer risk, cash flow visibility, growth outlook, etc. LP units are valued at our LP price target. GP values are determined by allocating a proportionate share of the consolidated equity value commensurate with the percent of total distributions the GP receives. We then net out C-Corp level debt and add back in forward year GP distributions received.

MLPs
For MLPs, our price targets are also based on a sum-of-the parts analysis. We value various business segments on a multiple of forward year(s) EBITDA, with multiples ranging from ~4x to ~13x. The spectrum range reflects a wide range of contract lives, commodity sensitivity, volume risk, customer risk, cash flow visibility, growth outlook, etc. We then net out forward year debt and minority interest to arrive at a consolidated equity value. From there we allocate equity value to the MLP based on the proportionate share of distributions the LP receives and add back in forward year distributions to be received.

MLP yield refers to the cash distributions paid out by the MLP, part of which may be treated as a return of capital rather that interest or capital gains.

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Opinion Key:
USCA uses a Buy, Overweight, Hold, Underweight and Sell rating system.

BUY - The stock has among the best combination of risk/reward and positive company specific catalysts within the sector. Stock is expected to trade higher on an absolute basis and be a top performer relative to peer stocks over the next 12 months.

OVERWEIGHT - The stock has above average risk/reward and is expected to outperform peer stocks over the next 12 months.

HOLD - The stock has average risk/reward and is expected to perform in line with peer stocks over the next 12 months.

UNDERWEIGHT - The stock has below average risk/reward and is expected to underperform peer stocks over the next 12 months.

SELL - The stock's risk/reward is skewed to the downside with possible negative company specific catalysts or excessive valuation. The stock is expected to trade lower on an absolute basis and be among the worst performers relative to peer stocks over the next 12 months.

Risks that may impede achievement of price target(s):
Industry wide risks include but are not limited to environmental and regulatory for both pipeline and E&P, aging infrastructure and availability of midstream infrastructure to accommodate new production. Competition for and availability of service crews and drilling rigs. Commodity prices, the economic outlook, access to capital markets. Interest rates. Asset recontracting. Cost overruns.

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Distribution of Ratings (as of May 7, 2021):

Recommendation	Count	Percent	Investment Banking Relationship	Count	Percent
Overweight/Buy	29	60%	Overweight/Buy	2	7%
Hold	19	40%	Hold	2	11%
Underweight/Sell	0	0%	Underweight/Sell	0	0%

Historical Ratings and Price Targets may be found by clicking the link below:

USCA Rating and Price Target History

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For a hard copy of our price target/ratings history or a hard copy of any report, please call 888-601-USCA (8722), or write to U.S. Capital Advisors, 4444 Westheimer Suite G500, Houston TX 77027.

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